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MACRO RISK ADVISORS

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Energy Market Commentary

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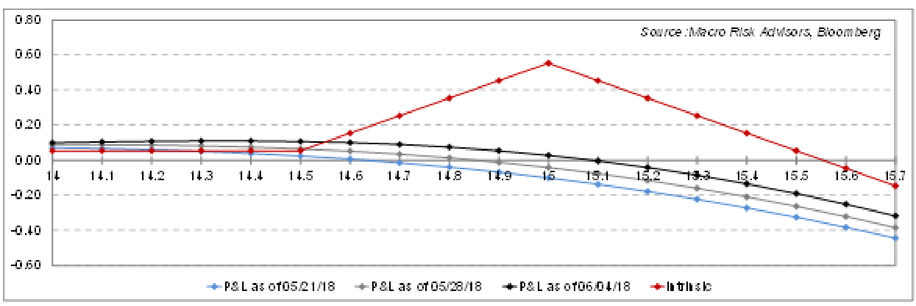
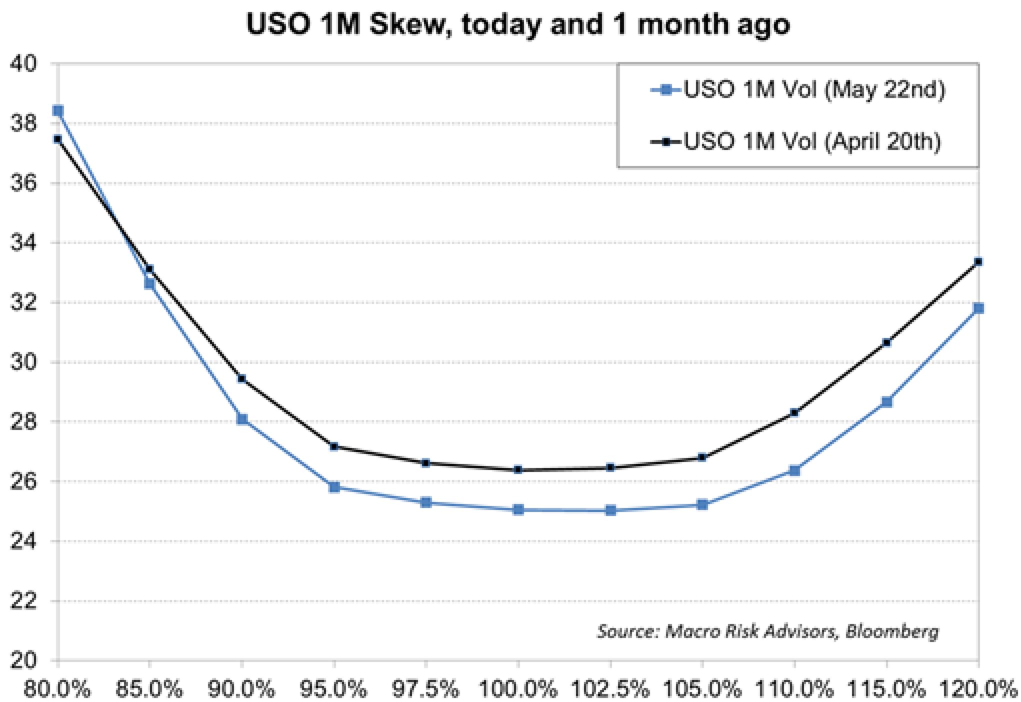
June OPEC Strategy: To hit a curveball, you have to wait for it to break

1. *We want to wait to buy any dip in oil post June OPEC, but would not add long deltas in the oil commodity into the event*
2. *We see the confirmation of the OPEC put pushing capital back into long energy equity trades and see XLE vol as underpriced.*
3. *We need to see a weaker USD, confirmation of resilient global demand, and commitment by U.S. E&Ps to the 'capital discipline' trade over June-August, before we can expect another leg higher in front-month oil prices and the additional steepening of backwardation.*

Delta Trade:
Buy USO June22nd 14.5/15 1x2 Call Spread for a 1cent credit, (ref. 14.67, -21d)



- To hit a curveball, you have to wait for it to break. On June 22nd, we expect OPEC to reiterate commitment to the existing production accord, notwithstanding the potential of incremental U.S. Iran sanctions and declining production across peripheral member states (e.g. Venezuela). In our view, this will be a vol dampening event in oil markets, reiterating a floor in front-month oil prices through 2H 18, but not providing the next catalyst higher for oil prices in the short-term.
- With 1-month USO call skew consistently bid over the last month, we want to wait for volatility to 'break' post the event to re-engage in upside long delta options strategies.



We do not want to pay-up for USO calls into June OPEC. From a shot-term risk/reward perspective, we see less upside surprises from OPEC rhetoric on June 22nd and more potential for OPEC to throw a bucket of cold water on oil prices headed into the summer months, with the group knowing full well the cooling effect of cautious messaging will be more than countered by robust seasonal demand in core OECD demand markets such as the U.S.

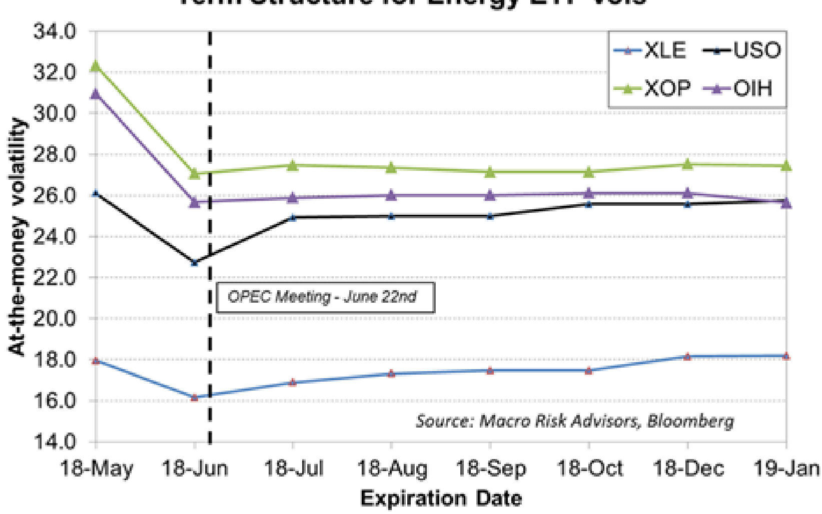
- Candidly, we do not believe we will see an additional rally in the oil commodity until the August/September time-frame when incremental macro-data confirms the pace/direction of USD weakness and resilient Chinese demand data. Yet, we believe long-term messaging from the meeting will be broadly consistent with current OPEC policy and will re-iterate a commitment to lower volatility, higher prices and, above all else, the goal of attracting capital back to the oil & gas industry value chain. This last piece of OPEC messaging is the most critical component and what we are looking for as evidence of a second leg in the bullish oil / energy trade in 2H 18.
- To be very clear, in the more intermediate-term we remain bullish on oil prices over the balance of 2018FY. If clients have traded our October tenor bullish USO options strategies, we see June OPEC as an opportunity to either take short-term profit or add deltas to exiting bullish trades coming out of the event. We prefer the latter strategy.
- Also, we think confirmation of the 'OPEC put' through at least 1H 19 will draw significant capital back into energy equities as upstream energy company FCF benefits from $70/bbl+ realized oil prices and a short-term lift to longer-dated futures increasing the mark-to-market value of oil reserves on company balance sheets. We believe this dynamic will create the most value at large-cap energy equities, resulting in a significant catch-up trade in energy equities versus the commodity, especially in market cap weighted indices/ETFs such as XLE.

OPEC Meeting	USO Move	XLE Move	XOP Move	OIH Move	UNG Move	RSX Move
Current Implied for June 22nd	1.09%	0.44%	1.23%	0.98%	0.56%	0.83%
11/30/2017	0.0%	1.5%	2.5%	1.9%	-4.1%	-0.6%
5/25/2017	-5.3%	-1.8%	-2.6%	-4.9%	-0.4%	-1.7%
4/24/2017	-0.7%	0.6%	0.8%	0.1%	-1.1%	2.4%
11/30/2016	8.6%	5.1%	11.6%	10.6%	0.6%	3.5%
9/28/2016	4.9%	4.3%	6.2%	6.0%	-1.4%	2.4%
6/2/2016	-0.6%	-0.1%	0.3%	-0.7%	0.7%	0.4%
12/4/2015	-2.4%	-0.6%	-2.7%	-1.8%	-0.2%	-2.7%
6/5/2015	1.2%	0.7%	1.5%	1.3%	-1.6%	1.7%
11/28/2014	-8.3%	-6.4%	-12.6%	-8.9%	-3.8%	-5.5%
7/11/2014	-2.0%	-0.8%	-1.5%	-0.6%	0.7%	0.2%
12/4/2013	1.1%	-0.3%	-0.3%	-0.5%	-0.1%	0.2%
5/31/2013	-1.9%	-2.1%	-2.1%	-2.1%	-1.0%	-4.2%
12/12/2012	1.0%	0.4%	0.4%	-0.3%	-0.5%	1.0%
6/14/2012	2.0%	1.6%	2.5%	1.8%	15.0%	1.3%
12/14/2011	-5.1%	-2.8%	-4.3%	N/A	-4.0%	-0.2%
6/8/2011	2.0%	0.3%	-0.1%	N/A	0.7%	-0.2%
12/13/2010	0.6%	0.8%	0.7%	N/A	-0.7%	-0.1%
10/14/2010	-0.4%	-0.2%	-0.2%	N/A	-0.3%	-0.4%
Average ABS Move	2.7%	1.7%	2.9%	3.0%	2.1%	1.6%

Vega Trade:
Buy the XLE 22-June 79 straddle for 3.28 (ref. 78.82, -5d)
Optional: Sell the XLE 15-June 79 straddle at 2.91 (ref 78.82, -6d)

The June at-the-money straddle price of $3.28 represents a 4.2% move going into June 22nd
However, the straddle for the June regular expiration a week before (without OPEC) is trading for $2.91
The difference (representing the implied volatility of the trading days between Jun 15th and June 22nd) is trading for just $0.37 , a <0.5% move (covering the OPEC meeting) where the average absolute XLE move after an OPEC meeting has been 1.7% (and the 25-May weekly straddle expiring this Friday is trading for $1.26, reflecting an implied 1.6% move this week)
The volatility term structure for all of the main energy ETF's is kinked higher for near-term weekly expirations, potentially reflecting investor expectations of elevated short-term realized volatility

Term Structure for Energy ETF Vols



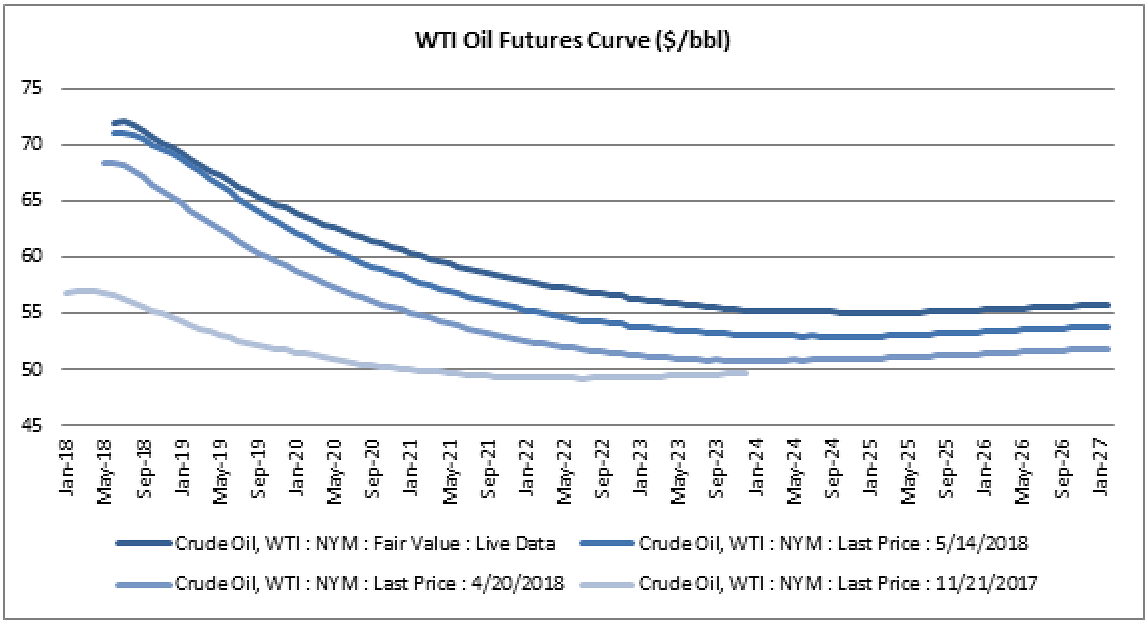
OPEC member states are scheduled to convene on June 22nd at the biannual plenary session in Vienna, in order to review current OPEC/non-OPEC policy measures. We believe long-term messaging from the meeting will be broadly consistent with current OPEC policy and re-iterate a commitment to lower volatility, higher prices and, above all else, the goal of attracting capital back to the oil & gas industry value chain. This last piece of OPEC messaging is the most critical component and what we are looking for as evidence of a second leg in the bullish oil / energy trade in 2H 18.

Notwithstanding, we also anticipate the June 22nd OPEC meeting message to include short-term nuance that attempts to cool the summer rally in near-dated oil prices. This could come in the form of increased Saudi exports to offset Venezuela production declines or broader rhetoric detailing the timing of the non-OPEC/OPEC unwind. In some form, we expect the formal June OPEC message to address production controls that will assure markets of limited upside from price shocks from both incremental U.S.-Iran sanctions and deteriorating Venezuelan production.

Moreover, OPEC is likely to address how far oil prices have rallied in 1H 18, acknowledging the rationalization of the global inventory overhang, while also underscoring their role as managing upside price risks just as much as downside price shocks. From a risk/reward perspective, to us this means that we see less upside surprises from OPEC rhetoric on June 22nd and more potential for OPEC to throw a bucket of cold water on oil prices headed into the summer months, knowing full well the cooling effect of cautious messaging will be more than countered by robust seasonal demand in core OECD demand markets such as the U.S.

Any dip should be bought, however, and messaging around increased Saudi exports alone will not be enough in our view to counter the longer-term structural supply issues currently presented by peripheral OPEC countries such as Venezuela and Angola. Also, we note that if the Saudis remain serious about the Saudi Aramco IPO in 1Q 19, any near-term increase Saudi exports we likely be looked through by market participants given the Saudis are likely to again dial back exports into the planned IPO to extract the best market pricing.

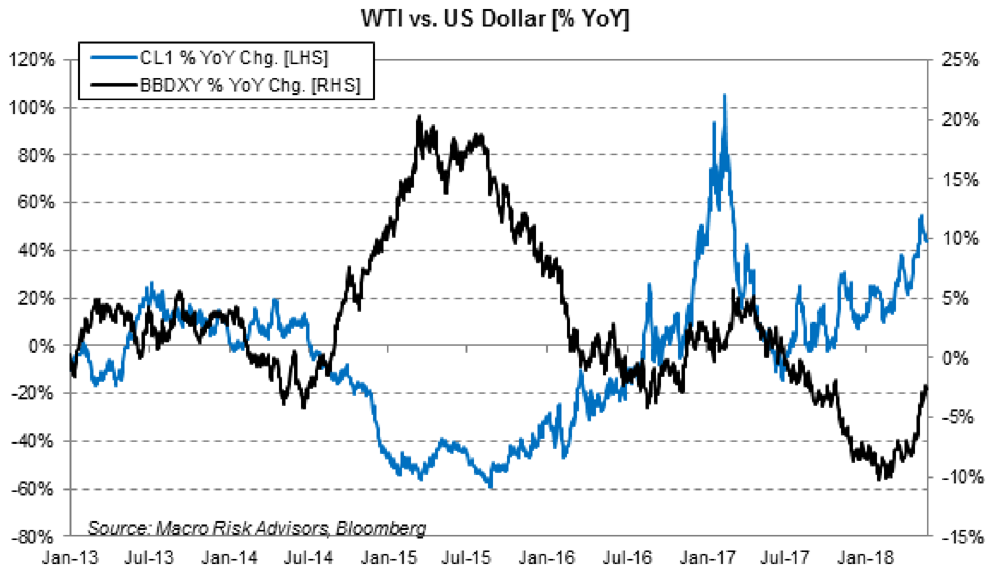
To be very clear, we remain bullish on oil prices over the balance of 2018FY, and see June OPEC as yet another buying opportunity rather than a short-term catalyst higher. If anything, OPEC could in fact shed more light on how deep Venezuela supply challenges reach through global oil markets and but a moderate bid in longer-dated oil futures relative to spot prices. While our call for *super-backwardation* in 2018FY remains intact year-to-date, with backwardated oil futures price conditions materially steeper through 2Q 18, we believe the next phase of OPEC's policy goals could be to temper front-month price appreciation while simultaneously stimulating longer-dated prices in order to increase the potential value of the Saudi Aramco IPO.



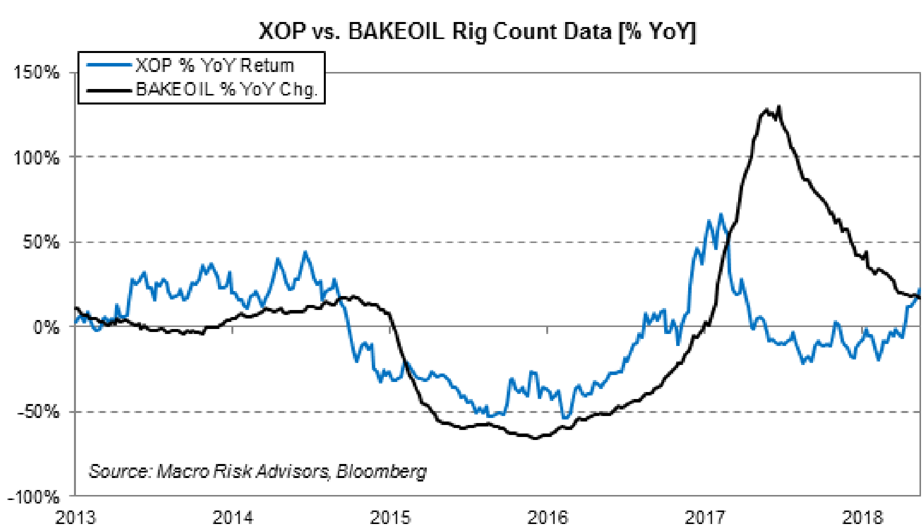
Source: Macro Risk Advisors, Bloomberg

Accordingly, we see June OPEC as potentially most positive for energy equities in the short-term e.g. July options expiry. This is significant given XLE is pricing in just a 0.44% move around the June 22nd event, versus front-month oil futures (USO) pricing in a 1.1% move. We expect OPEC commitment to the existing production accord, in the face of potential incremental U.S. Iran sanctions and declining production across peripheral member states, will at least put a floor in front-month prices. This 'OPEC put' dynamic we believe will draw significant capital back into energy equities as energy companies FCF benefits from $70/bbl+ realized oil prices, will a short-term lift to longer-dated futures increases the mark-to-market value of oil reserves on company balance sheets. We believe this dynamic will create the most value at the large-cap equity level and result in a significant catch-up trade in energy equities versus the commodity.

We want to underscore, we are not calling 'time' on our *super-backwardation* thesis, but rather tempering the call for June-August, given timing of the U.S. summer driving season. Moreover, while oil markets continue to weather the near-term disruptive risks of a stronger USD, the tailwind of a weaker USD to the synchronized global growth story is a key lynch pin to our 2018FY bullish oil call. For front-month oil prices to take another sustained leg higher, U.S. dollar weakness will likely need to resume over 2H 18 through a combined recovery in near-term EU statistics such as PMIs, in tandem with resilient demand from key EM economies such as China through the August/September timeframe.



We believe these potential headwinds to growth will likely keep investors/traders 'on the beach' through at least July, waiting for clear evidence of another leg higher in demand-led oil price recovery, underpinned by consisntent OPEC oil market policy and the commitment of U.S. E&P management's to 'capital discipline'. With WTI spot crude oil prices firmly above $70/bbl, the risk that E&P managements' begin to chase production targets over shareholder returns lurks behind the glossy green positive price action in U.S. upstream equity performance year-to-date. A sudden lurch higher in the U.S. oil rig count, is another risk to our *Wire-to-Wire* oil thesis over 2018FY.



To sum up, the challenge facing OPEC goes beyond the recovery of front-month oil prices back to the $80/bbl oil level. OPEC needs to convince investors that it is still relevant in a world where the threat of electric vehicles looms large over the long-term value of Middle East oil sovereigns. While OPEC is deeply aware of the situation facing its sovereign member state Venezuela and other peripheral members such as Angola, it is also deeply aware of a long-term identity crisis revealed by the advent of U.S. shale production and amplified by increased sovereign credit risk at $25/bbl WTI in 1Q 16. If we rewind to last October's meeting, Al-Falih's comments centered around managing upside price shocks as well as downward price pressure, and the structural supply shortfalls reported in Venezuela year-to-date are the exact phenomena that could result in supply related price shocks, rather than positive demand led price recovery. Yet, even more importantly, Al-Falih understands Saudi Crown Prince Mohammad Bin Salman's plan to transform Saudi Arabia into a competitive economy of the 21st century and beyond. The latter requires higher prices from now until the Aramco IPO. We are betting on the latter re-enforcing the 'OPEC put' on June 22nd and would be buyers of any dip post June OPEC and over the summer months to increase exposure to our long oil trade into 3Q 18.